

1 No. 10913

FILED
MAR 30 1945

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Supreme Court of the United States

October Term, 1944.

F. G. BADENHAUSEN, WILLIAM S. SPATCHER
and HOWARD H. HUBBARD, constituting the
Protective Committee for the holders of Georgia
and Alabama Railway First Mortgage Consolidated
Five Per Cent. Gold Bonds, Due 1945, and LES-
TER MARTIN,

Petitioners and Appellants Below,

AGAINST

EDWIN G. BAETJER, GEORGE C. CUTLER, AU-
STIN McLANAHAN and A. H. S. POST, constitut-
ing the Seaboard Air Line Railway Company Un-
derlying Bondholders' Protective Committee,

Respondents and Appellees Below.

Petition for a Writ of Certiorari to the United States
Circuit Court of Appeals for the Fourth Circuit,
and Brief in Support Thereof.

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INDEX.

	PAGE
PETITION :	
Statement of the Matter Involved	2
This Court Has Jurisdiction	6
The Questions Presented	7
Reasons Relied Upon for Allowance of Writ	8
Conclusion	11
BRIEF :	
Opinions of Courts Below	13
Jurisdiction	13
Statement of the Case	14
Specification of Errors	14
ARGUMENT :	
Summary of the Argument	15
POINT I.—A conflict of interest unquestionably exists between the several divisional mortgages purportedly represented by the Underlying Bondholders Protective Committee	15
POINT II.—A Protective Committee may not represent conflicting interests as it is unfair to investors and not consistent with public policy or public interest	21
POINT III.—This Court has held that Protective Committees, as well as Indenture Trustees, are fiduciaries and cannot represent conflicting interests in a reorganization. The decree of the Circuit Court of Appeals is in conflict with the applicable decisions of this Court	27
Conclusion	29

CASES CITED.

	PAGE
American United Mutual Life Insurance Company v. City of Avon Park, 311 U. S. 138 ..	7, 8, 10, 14, 24, 25
Bullard v. City of Asco, 290 U. S. 179	6, 8, 14, 27
Jackson v. Smith, 25 U. S. 586, 589	25
Meinhard v. Salmon, 249 N. Y. 458, 464; 164 N. E. 545	27
Weil v. Neary, 278 U. S. 160, 173	26
Woods v. City National Bank and Trust Company of Chicago, et al., 312 U. S. 262 ..	6, 8, 14, 24, 26, 27, 28

AUTHORITIES CITED.

C. 229; 43 Stat. 938, Amending Judicial Code, Sec- tion 240, Title 28, U. S. C. A., Section 347 and under Rule 38, subdivision 5, of the Rules of the Supreme Court	6, 13
Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protec- tive and Reorganization Committees made pur- suant to Sec. 211 of the Securities and Exchange Act of 1934	21
General Rules and Regulations of the Securities and Exchange Commission	22
Sec. 77 of Bankruptcy Act	2, 23, 26
Sec. 205 (p), U. S. C. A.	2, 26

Supreme Court of the United States

OCTOBER TERM, 1944.

F. G. BADENHAUSEN, WILLIAM S. SPATCHER and HOWARD H. HUBBARD, constituting the Protective Committee for the holders of Georgia and Alabama Railway First Mortgage Consolidated Five Per Cent. Gold Bonds, Due 1945, and LESTER MARTIN,
Petitioners and Appellants Below,

AGAINST

EDWIN G. BAETJER, GEORGE C. CUTLER, AUSTIN McLANAHAN and A. H. S. POST, constituting the Seaboard Air Line Railway Company Underlying Bondholders' Protective Committee,
Respondents and Appellees Below.

Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

To the Honorable, the Supreme Court of the United States:

The petitioners, F. G. Badenhause, William S. Spatcher and Howard H. Hubbard, constituting the Protective Committee for the holders of Georgia and Alabama Railway First Mortgage Bonds, and Lester Martin respectfully petition this Honorable Court for a writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit to review the decree of the Circuit Court of Appeals entered on January 3, 1945, affirming the order of the District Court dated May 20, 1944, which denied the relief sought by the petitioners herein and dismissed the petition filed by them.

Statement of the Matter Involved.

But one issue is presented to this Court—can a bondholders' protective committee in a reorganization in equity properly and legally represent and act for several conflicting classes of mortgagees. The "Badenhausen" committee, one of the petitioners in this case, was authorized by the Interstate Commerce Commission on August 23, 1943, pursuant to Section 77 (p) of the Bankruptcy Act, 11 U. S. C. A., Section 205 (p), to solicit from holders of the Georgia and Alabama Railway First Mortgage Bonds authorizations to represent them in the consummation of a plan for the reorganization of the Seaboard Air Line Railway Company proposed in an equity proceeding in the District Court; the petitioner Lester Martin is a substantial holder of Georgia and Alabama Railway First Mortgage Bonds (Actuals), and also holds Georgia and Alabama Railway Certificates of Deposit, which are at present represented by a committee known as the "Seaboard Air Line Railway Underlying Bondholders' Protective Committee",* in the principal amount of \$321,000. The Underlying Bondholders' Committee consists of Edwin G. Baetjer, Chairman, and George C. Cutler, Austin McLanahan and A. H. S. Post.

The petition filed by the petitioners herein (R. 1-5) prayed for an order directing that the Underlying Bondholders' Committee cease to represent and act for bondholders of the Georgia and Alabama Railway, and to further require it to show cause why the deposit of the Georgia and Alabama Railway bonds with said committee should not be withdrawn.

The petitioners filed their petition in the above cause against Edwin G. Baetjer and others constituting the Underlying Bondholders' Committee on November 1, 1943, while the hearings were pending before the District Court

*Hereinafter designated as "Underlying Bondholders' Committee".

on the plan of reorganization of the Seaboard Air Line Railway in equity receivership. In due course, on November 5, 1943, the said Underlying Bondholders' Committee filed an answer (see R. 7-14) to said petition, but the hearing was deferred by the District Court until April 20, 1944,* when a hearing was held on said petition and answer. Thereafter the District Court denied the relief sought by the petition herein and dismissed the same by an order dated May 20, 1944. The appeal was taken from said order.

In addition to the Georgia and Alabama Railway First Mortgage Bonds, the Underlying Bondholders' Protective Committee represents the holders of certificates of deposit for nine other issues of divisional mortgage bonds of the Seaboard Air Line Railway Company; also, the holders of certificates of deposit for bonds of Georgia and Alabama Terminal Company, a subsidiary of said Seaboard Air Line Railway Company, said issues of underlying divisional bonds being as follows: Carolina Central Railroad Company, Florida Central and Peninsular Railroad Company, Florida West Shore Railway, Georgia, Carolina and Northern Railway Company, Raleigh and Augusta Air Line Railroad Company, Raleigh and Gaston Railroad Company, Seaboard Air Line Railway Atlanta-Birmingham, The Seaboard and Roanoke Railroad Company, and The South Bound Railroad Company-Southern Division.

The Underlying Bondholders' Committee holds on deposit at the present time approximately fifty per cent. of all issued and outstanding Georgia and Alabama Railway Company First Mortgage Bonds, pursuant to the terms of the deposit agreement dated August 1, 1931. This deposit agreement grants to the said Underlying Bondholders' Committee certain rights and powers, includ-

*The Plan of Reorganization of the Seaboard Airline Railway was approved by the District Court December 13, 1943.

ing actual title to the bonds on deposit, with the right to vote, represent or assent, on behalf of the bonds deposited with it, to any plan of reorganization or recapitalization, and particularly in the pending equity receivership and reorganization proceedings involving the recapitalization of the Seaboard Air Line Railway and the allocation of new securities to the several underlying divisional mortgages. Each of the underlying divisional mortgage issues receives different treatment under the plan of reorganization proposed by the Special Master, which was confirmed by the District Court, with certain modifications.

Prior to the reorganization, the grand total of principal and interest of secured debt in the hands of the public was \$340,251,484.64, exclusive of capital stock. Under the plan of reorganization, the total capitalization, including all debt and stock, was \$196,870,000.

Under the plan of reorganization and recapitalization approved by the District Court, some of the underlying divisional mortgage liens received full payment, others received varying amounts or proportions of the principal and interest due on said mortgage liens. It is estimated that the Georgia and Alabama Railway bondholders receive approximately thirty per cent. of their total claims for principal and interest, under the pending plan of reorganization.

It is clear that the fund which is to be divided among the various underlying divisional mortgages is a limited fund. It is likewise clear that each underlying divisional group of bondholders received different treatment under the plan of reorganization approved by the District Court.

The answer filed by the respondents to the petition *admitted* that a conflict of interest existed between the various mortgage divisions the moment there was a limited common fund to be divided among the several underlying liens (R. 11). This was likewise admitted by Mr. Baetjer, Chairman of the Underlying Bondholders' Com-

mittee, who testified on cross-examination (R. 20-21; 25-28).

Mr. Baetjer admitted that one of the primary reasons his committee was formed to represent ten different divisional mortgages was due to the fact that his clients, the trust companies and banks (who are represented on the committee), owned bonds of all of said mortgage issues (R. 17-19; 29-30).

He further stated that at the time he organized the Underlying Bondholders' Committee in August, 1931, his main objective was to see that all of the underlying bonds were paid in full (R. 18-19, 26). However, Mr. Baetjer admitted on cross-examination that he realized some time in 1934 or 1935 that all the underlying liens would not be paid in full (R. 26, 27, 28-31).

Mr. Baetjer further admitted that he knew the several mortgage divisions represented by the Underlying Bondholders' Committee were of different and unequal value (R. 20, 22, 23, 32). Mr. Baetjer on cross-examination admitted that the Underlying Bondholders' Committee undertook to determine the equitable distribution of the limited funds to each of the underlying divisional mortgages it represented, but contended that the committee had that right under the deposit agreement (R. 32, 34-35; 39-41).

To determine the value of each mortgage division, it was necessary to determine their earnings. Several theories or formulae were advocated for this purpose, as well as several test periods. Mr. Baetjer admitted that each proposed formula and test period applied to the various divisional mortgages would produce different results, some more favorable to one mortgage issue and some more favorable to others (R. 34-37; 39, 54). Mr. Baetjer further admitted that each divisional mortgage issue, if left to its own bondholders and resources, would unquestionably advocate the formula and test period most favorable to that issue (R. 39, 41-44). Respondents also admitted

that when the bondholders deposited their bonds with the committee and agreed to pay the committee for its services, they did so in the belief and on the understanding that their particular bond issues would receive the best representation possible (R. 40-42; 43).

The issue involved in the case is whether a bondholders' protective committee may legally or equitably represent conflicting interests or classes in a pending reorganization, or whether equitable principles and public policy and public interest require that a protective committee should not represent any group or class whose interests conflict with another class which it represents.

This Court Has Jurisdiction.

The decision of the issue involved in this case by the Circuit Court of Appeals is not only in conflict with the weight of authority, but is clearly in conflict with applicable decisions of this Court. (Supreme Court Rule 38, Paragraph [5] [b].) This Court has held in the case of *Bullard v. City of Asco*, 290 U. S. 179, that protective committees as well as indenture trustees are fiduciaries. In the case of *Wood v. City National Bank and Trust Company of Chicago, et al.*, 312 U. S. 262, in discussing the question of compensation, this Court plainly indicated that a fiduciary or protective committee could not represent conflicting interests in a reorganization, when this Court stated

“A fiduciary who represents security holders in a reorganization may not perfect his claim for compensation by insisting that, although he had conflicting interests, he served his several masters equally well or that his primary loyalty was not weakened by the pull of his secondary one. Only strict adherence to these equitable principles can keep the

standard of conduct for fiduciaries, 'at a level higher than that trodden by the crowd'."

The same principles were authoritatively set forth by this Court in the case of *American United Mutual Life Insurance Company v. City of Avon Park*, 311 U. S. 138.

The Circuit Court of Appeals stated (R. 123) that it recognized the force and effect of the principles and regulations governing the representation by a protective committee of conflicting interests. In addition, the Circuit Court of Appeals stated that the propriety of the underlying principles set forth by the Supreme Court of the United States could not be questioned, but the Circuit Court of Appeals nevertheless affirmed the decision of the District Court which sanctioned such representation of conflicting interests by a protective committee.

This Court clearly has jurisdiction to review and reverse the decision of the Circuit Court of Appeals which is in conflict with applicable decisions of this Court.

The Questions Presented.

1. Does any conflict of interest exist between the various divisional mortgage liens represented by the Underlying Bondholders' Committee?

2. If such a conflict of interest does exist, can the Underlying Bondholders' Committee equitably and legally represent or act for the several conflicting classes of mortgage liens?

The total amount of new securities allocated to all the underlying divisional bondholders is fixed and limited, and is far less than the face amount of the present outstanding obligations accrued and due on said mortgage liens. It is apparent that any increase in the amount of securi-

ties received by one divisional group will be at the expense of one or more of the other divisional groups, and to that extent the interest of each divisional group necessarily conflicts with that of the other divisional groups.

It is petitioners' contention that a conflict of interest unquestionably exists between the several underlying divisional liens represented by the Underlying Bondholders' Committee; that it is improper in equity that the same committee should represent conflicting interests or classes; and that public policy and public interest require that a protective committee should not represent any group or class whose interests conflict with those of another group or class which it purportedly represents.

Reasons Relied Upon for Allowance of Writ.

1. The decision below of the Circuit Court of Appeals is in conflict with the decisions of this Court in the cases of *Wood v. City National Bank and Trust Company of Chicago, et al.*, 312 U. S. 262, *American United Mutual Life Insurance Company v. City of Avon Park*, 311 U. S. 138, and *Bullard v. City of Asco*, 290 U. S. 179. In these cases, this Court has authoritatively and forcefully set forth the equitable principles that protective committees as well as indenture trustees are fiduciaries, and that fiduciaries and protective committees cannot represent conflicting interests in a reorganization. The order of the District Court which was affirmed by the Circuit Court of Appeals and which denied and dismissed the petition filed by the petitioners herein clearly sanctioned the representation by a protective committee of several conflicting interests in a reorganization.

2. The question of representation is not "moot". The fact that the plan of reorganization has been approved by the District Court and by the Circuit Court

of Appeals for the Fourth Circuit does not render the question of representation "moot". An appeal is still pending and undetermined on the same plan of reorganization before the Circuit Court of Appeals for the Fifth Circuit, and, in addition, foreclosure proceedings are still pending before the District Court, which will have to determine the "upset price" of the properties involved. It has always been the contention of the petitioners that the treatment afforded the Georgia and Alabama bondholders is inadequate and inequitable. Consequently, petitioners will seek a higher "upset price", more representative of the true value of the Georgia and Alabama Division. On the other hand, it is understood that the respondents do not seek a higher "upset price", as they have approved the plan of reorganization and the treatment accorded the Georgia and Alabama bondholders. Furthermore, the respondents have signified their intention to assent to the plan of reorganization on behalf of Georgia and Alabama bonds deposited with the committee, irrespective of the fact that many holders of certificates of deposit, who are the true owners of these Georgia and Alabama bonds, have indicated their dissent and disapproval of the plan of reorganization. This is clearly shown in the case of Lester Martin, one of the petitioners herein, who holds and owns \$321,000 of the Georgia and Alabama Certificates of Deposit, and who has unequivocally indicated his disapproval of the plan of reorganization. Unless the decision of the Circuit Court of Appeals is reversed and the petition filed by the petitioners herein is granted, the bonds of the Georgia and Alabama Division held by the Underlying Bondholders' Committee will be deposited in favor of a plan of reorganization which is favorable to other interests represented by the respondent committee, but not to the Georgia and Alabama bondholders. Surely, a bondholder whose bonds are held by the Underlying Bondholders' Commit-

tee and who does not desire to approve the plan of reorganization should have a right to insist that his bonds be not used for this purpose when the same committee which holds his bonds represents conflicting interests. It will be noted, accordingly, that the question of representation presented in this petition for certiorari is far from "moot".

3. The respondents have sought to justify their position in representing conflicting interests by referring to other railroad reorganizations, where certain institutional groups appeared, representing several different bond issues. The decision of the Circuit Court of Appeals likewise relies upon this fact (R. 123). It is apparent that any person or institution may appear in any proceeding to represent his or its interests, regardless of the fact that he or it owns several of the bond issues involved in the reorganization. It is likewise apparent that the interest of that person or institution may rest primarily in one or more particular bond issues, which are consequently favored. That is their prerogative, but that situation is *not analogous* to the case in point. Here we have a protective committee which purports to represent *public holders*, as distinguished from private interests. Here we have a protective committee which is acting intrinsically in a fiduciary capacity for *public investors*, and which purports to and should have *undivided loyalty* to the class which it represents. In addition, the committee is charging the public investors fees and compensation for services, which necessarily implies loyal and disinterested service in the interests solely of those for whom the committee purports to act. *American United Mutual Life Insurance Company v. City of Avon Park*, 311 U. S. 138.

CONCLUSION.

For these reasons, we respectfully submit that this petition for a writ of certiorari should be granted.

Dated, March, 1945.

Respectfully submitted,

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HARRY O. LEVIN,
Of Counsel.